



Market Commentary
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Insigneo Weekly Dispatch

From the Uneventful to the Revolutionary: The Fed and DeepSeek

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From the Uneventful to the Revolutionary: The Fed and DeepSeek

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If the architecture behind DeepSeek is validated, it could potentially make AI affordable to developers everywhere. This development could reshape the industry in two ways: 1) Reducing the need for high levels of spending on computing power to successfully train and use AI and 2) Allowing AI to be adopted much faster and broadly than previously expected.

A Whirlwind. That is one way to describe this past week in U.S. financial markets. From the Federal Reserve, to DeepSeek, to earnings reports. The markets were not short of action to close the first month of the year. We will leave the earnings discussion for another week, once we have greater visibility of the full earnings season. However, there were two events this week worth digging further into - one rather uneventful, the other one potentially revolutionary.

The Uneventful

Let us start with the uneventful. During the Federal Reserve's first meeting of the year on Wednesday, Chairman Jerome Powell conveyed to the markets exactly what he wanted: absolutely nothing new. After the Fed announced that it was going to leave rates unchanged in a range between 4.25% - 4.50%, Powell gave rather ambiguous answers to questions from reporters at the ensuing press conference. His answers were ambivalent by design, not because he was unsure of what he was saying, but because he wanted to maintain all options on the table, in light of

the uncertainty surrounding some of the new administration's policies. Even after markets retreated in response to the Fed's removal of seemingly benign language on inflation from its official statement, Powell quickly dispelled any notions of increased hawkishness by characterizing the removal as a simple "language cleanup". Perhaps Powell's most important statement of the afternoon was "we do not need to be in a hurry" to cut rates, emphasizing that the Fed has the luxury to take the time needed to evaluate incoming data to decide on the direction of rates. This was exactly what the market had expected, no meaningful rate cuts any time soon, perhaps two 25bps cuts by the end of the year. After the Fed released its statement, the S&P500 initially dropped, after Powell spoke it rose, yet by the end of the day, the index was nearly perfectly unchanged from the time of the Fed's initial release. No meaningful market movements from Wednesday's release as the Fed got the uneventful outcome it wanted.

The Revolutionary

However, Monday the 25th was anything but uneventful. In one day, the Nasdaq Composite Index lost approximately one trillion dollars in market capital. The brunt of this drop was borne by one company, Nvidia, which shed \$589 billion in market value, breaking the record for the single largest drop in market value in one day, and losing its place as the largest company in the world. The culprit for the unparalleled drop: DeepSeek.

What exactly is DeepSeek? DeepSeek is a Chinese Artificial Intelligence company that produced large language model R1, much like the Chat-GPT family of models. However, unlike Chat-GPT, DeepSeek is an open-source model, meaning that its underlying code is freely available for other developers to access, use, and modify as they see fit. So, why is

DeepSeek potentially revolutionary for the AI industry? The answer is twofold: First, as we said before, the source code can be accessed by anyone. Second, and likely more important, is that DeepSeek may be of similar quality as the other proprietary AI models, yet it may potentially have significantly lower training and inference costs. According to Bloomberg, a University of California Berkley affiliated leaderboard named Chatbot Arena recently ranked DeepSeek as one of the top three chatbots in the industry in terms of performance. If proven to be true, this could make DeepSeek groundbreaking for the AI industry.

To draw a parallel, let us think of the origins of the automobile. When asked "Who invented the automobile?" the most common answer would probably be "Henry Ford, when he created the famous Model-T". However, Henry Ford did not invent the first car. The first commercially available gasoline-powered car was invented by Karl Benz in the late 1800's. However, these cars were expensive to build and not easily affordable by the public. Ford's importance stemmed from the fact that, by perfecting the assembly line, he reduced the price to build a car, therefore reducing its retail price and making it affordable to the masses. If the architecture behind DeepSeek is validated, it could potentially make AI affordable to developers everywhere. This development could reshape the industry in two ways: 1) Reducing the need for high levels of spending on computing power to successfully train and use AI and 2) Allowing AI to be adopted much faster and broadly than previously expected.

First, by making AI development less expensive, models like DeepSeek's R1 could erode the dominant competitive positions and high margins of companies like Nvidia. Nvidia has been the undisputed darling of the AI boom. However, it is reported that DeepSeek does not need Nvidia's high-end Blackwell GPU chips to operate. In fact, it seems that

the model operates using Nvidia's older, less expensive H800 chips. This could mean that the high expectations built into Nvidia's stock price may not be met, at least not as soon as quickly as the street was expecting. This would explain the stock's near 20% drop on Monday. But this impact would not be confined to Nvidia alone, other chip makers could also be affected. In fact, Monday saw the entire Philadelphia Semiconductor Index drop to levels not reached since 2020. The potential impact of DeepSeek does not end there. Before this week, the idea behind the AI revolution was that it was going to require large amounts of spending, not only for the construction of the AI models themselves, but also for the infrastructure required to create and operate them. Bloomberg estimates that the combined spending by Microsoft, Amazon, Oracle, Alphabet, and Meta on the servers and infrastructure required by the AI boom grew from \$98 billion in 2020 to \$224 billion by the end of 2024. It further estimates this spending to jump to \$275 billion by the end of this year. At the same time, energy companies producing the vast amounts of power required to operate the infrastructure of AI have been ferociously jockeying for position to become the main power suppliers to the industry. The emergence of DeepSeek puts in question the need for this vast and expensive infrastructure. As a result, it should come as no surprise that the best stock in the S&P 500 in 2024, nuclear energy producer Vistra Energy, collapsed nearly 30% on Monday.

Second, the low-cost and comparably good quality of models like DeepSeek should allow for the faster development and adoption of Artificial Intelligence. As we stated earlier in the week "As input and output costs fall, propagation of the new technology will occur at a faster pace (Jevon's paradox). This development is a great thing and something to be cheerful about." (Riesgo,1/27/25). This dynamic will have a long-term effect on the end users of AI, but a more

immediate and meaningful impact on the software companies developing this technology. We envision the Artificial Intelligence eco-system as an inverted pyramid, resembling the letter "V". A limited number of hardware companies like Nvidia and other chip-makers constitute the bottom level of that inverted pyramid, with a larger number of software developers making up the subsequently wider portion of the pyramid, and a vastly larger number of "end beneficiaries" of AI constituting the final, much wider portion. We have often referred to the hardware companies as the "enablers" of AI, and the software developers as its "users". We have been expecting the natural transition in the AI development cycle from the "enablers" to the "users" of the technology, for some time. In fact, we wrote about the rotation out of hardware company stocks into software companies last November, in a piece titled [Sequels are Rarely as Good as the Original Movie](#) In it we wrote: "This rotation could create an interesting tactical investment opportunity, where investors that do not want to reduce their overall exposure to the Technology sector could reduce their exposure to some of the mega-cap hardware companies and increase their exposure to relatively smaller software companies". (Viaud,11/21/24). We believe that this rotation will continue, and the emergence of DeepSeek and its inevitable copycats will greatly speed up the process. **The next phase of the AI transition is happening now.**

Given our views, the logical question would be: "What companies could benefit over the long term?". The answer is multi-layered. First, software companies like Snowflake (SNOW), Palantir Technologies (PLTR), Salesforce (CRM), Oracle (ORCL), Palo Alto Networks (PANW), Cloudflare (NET) and Adobe (ADBE) could benefit over time. Chip makers that produce relatively less expensive chips, such as Taiwan Semiconductor (TSM) and Broadcom (AVGO)

could also benefit over time. Additionally, although the infrastructure needed for AI might turn out to be less than initially expected, a large amount of infrastructure will still be needed. This could potentially yield long-term benefits for infrastructure companies like Vertiv Holdings (VRT) and Arista Networks (ANET), as well as energy producers such as Equitable (EQT), NextEra Energy (NEE), Dominion Energy (D), and Constellation Energy (CEG). Lastly, even hyperscalers like Microsoft (MSFT), Meta (META), Alphabet (GOOG) and Amazon (AMZN) are likely to be long term beneficiaries as their development costs eventually decrease.

As you can probably tell by the discrepancy in the amount of space dedicated in this piece to “The Un-eventful” versus “The Revolutionary” topics, we believe that the latter could have a very meaningful long-term impact on markets and industry alike. One that we expected and foresaw, but even we were surprised by how quickly it is unfolding. In essence, Henry Ford democratized the automobile, revolutionizing the transportation industry and society as we know it. If validated, DeepSeek’s R1 and other such models could democratize artificial intelligence, changing technology and potentially society as we know it.

It is important to note that we are by no means endorsing or recommending that investors blindly run out and buy the stocks mentioned above, as they can be highly volatile in nature and are not suitable for every investor. We are simply providing some options which investors could research further, if they are considering attaining exposure in this space. We highly encourage clients to consult with their financial advisors to determine suitability for their individual situations. ■



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